

Petition of Southern Union Company for authorization and approval of (1) the issuance of up to \$400 million of long-term debt in the form of notes or debentures and (2) an exemption from the provisions of G.L. c. 164, §§ 15 and 15A.

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FOR: SOUTHERN UNION COMPANY

Petitioner

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Intervenor

I. INTRODUCTION

On February 16, 2001, Southern Union Company ("Southern Union" or "Company") petitioned the Department of Telecommunications and Energy ("Department") pursuant to G.L. c. 164, § 14 for approval to issue and sell long-term debt securities in the

principal amount of up to \$400 million, with a maturity of seven to 30 years. As part of its petition, the Company requested an exemption from the requirements of G.L. c. 164, §§ 15 and 15A. The Department docketed the filing as D.T.E. 01-32.

On March 14, 2001, the Division of Energy Resources ("DOER") filed a petition to intervene in the proceedings. Pursuant to notice duly issued, the Department conducted a public hearing at the Department's offices on March 22, 2001. At this hearing, the Department granted DOER's petition to intervene. The Department held an evidentiary hearing immediately after the public hearing. In support of its petition, the Company offered the testimony of Cheryl Yager, assistant treasurer for Southern Union. The evidentiary record consists of 18 exhibits and two responses to record requests. On April 4, 2001, the Company submitted a brief in support of its petition.

II. DESCRIPTION OF THE PROPOSED FINANCING

A. Issuance of Long-Term Debt

The Company proposes to issue and sell unsecured long-term debt securities in a principal amount not to exceed \$400 million, with a single maturity date that is at least seven years but no more than 30 years, and with no call features (Exhs. SU-1, at 3; SU-5). The Company asserts that the proposed debt will be issued under the same indenture as its currently outstanding 7.6 percent and 8.25 percent Senior Notes (Exh. SU-1, at 3). The Company seeks the right to amend the specific terms of the debt instrument, if market conditions warrant at the time of the issuance (id.).

The Company also proposes a maximum interest rate of 9.0 percent for its long-term debt securities due to the capital market's volatility in recent years (id. at 4).⁽¹⁾ The Company anticipates that the proposed debt will be sold on the public market (id. at 3).

Finally, the Company seeks approval by the Department of its petition no later than May 1, 2001 because it faces a June deadline for determining whether to convert or to extend its existing short-term notes (id. at 5). The Company states that the majority of its short-term debt is scheduled to mature on August 27, 2001 (id.).⁽²⁾ The Company claims that it needs approval by May 1, 2001 to complete the issuance of any long-term debt that the Department approves and to have time (1) to evaluate the results of the issuance and (2) to determine the precise amount of short-term debt that will be extended (id.). The Company notes, however, that the precise timing is contingent upon regulatory approval⁽³⁾ and prevailing market conditions (id. at 4).

The Company claims that the proceeds from the proposed issuance of the long-term debt will be used to retire short-term debt (id. at 3). The Company states that the short-term debt was used (1) to fund expenditures for capitalizable additions, as well as the acquisition, extension, and improvement of utility plant and property and (2) to finance investments in its utility operations, including the expansion and replacement of underground distribution facilities and to fund safety-related expenditures (Exhs. SU-1, at 6; SU-5).

B. Exemption from G.L. c. 164 §§ 15, 15A

The Company contends that it would be in the public interest for the Department to grant an exemption from the competitive bidding and publication requirements of G.L. c. 164, § 15 in the present case because there is already a measure of competition in its private placement process and flexibility is necessary in order to respond quickly to changes in market conditions and to facilitate the use of a variety of pricing mechanisms (Ex. SU-11; Company Brief at 11-13). The Company argues that it would be in the public interest for the Department to grant an exemption from the par value requirements of G.L. c. 164, § 15A in the present case because (1) market conditions make it difficult for the Company to price a particular issue at par value and simultaneously offer an acceptable coupon rate to prospective buyers; and (2) a sale at less than par value offers the Company enhanced flexibility in entering the market quickly to take advantage of prevailing interest rates (Ex. SU-12; Company Brief at 13-14 citing Boston Edison Company, D.T.E. 98-118, at 43 (1999); Colonial Gas Company, D.P.U./D.T.E. 97-83, at 11 (1997)).

III. CAPITAL STRUCTURE OF THE COMPANY

As of December 31, 2000, the capital structure of the Company included utility plant in service of \$2,085,964,000 and gas inventories held by regulated utilities of \$103,976,000, less accumulated depreciation of \$722,446,000 (Exh. SU-2). Thus, as of December 31, 2001, the Company has a net utility plant, excluding accumulated depreciation, of \$1,467,494,000 (id.). As of December 31, 2000, the Company reported a total capitalization of \$1,213,722,000 (excluding retained earnings), which consisted of long-term debt and capital-lease obligations of \$851,757,000 (including the proposed \$400,000,000 issuance of the long-term debt), common stock of \$308,938,000, and preferred stock of \$53,027,000 (id.).

The Company proposed several adjustments to its year-end capitalization and net utility plant balances (Exh. SU-1, at 8). First, the Company reduced its long-term debt and capital lease obligations by \$529,000,000 to remove the outstanding 364-day term loan, which the Company considers to be a short-term obligation for purposes of G.L. c. 164, § 14

(Exhs. SU-1, at 9; SU-4). Second, the Company excluded from net plant in service \$51,772,000 associated with unregulated operations, with a corresponding reduction of \$51,772,000 to total capitalization, based on a pro rata reduction of long-term debt by \$26,370,000, a reduction to preferred stock by \$3,095,000, and a reduction to premium on common stock by \$22,307,000 (Exhs. SU-1, at 9-10; SU-3, at 5; Tr. at 12-13).⁽⁴⁾ Third, the Company excluded \$733,893,000 associated with acquisition premiums representing the excess of the purchase price over book value of several natural gas utilities acquired in recent years (Exhs. SU-1, at 11; SU-4; SU-5). A corresponding reduction of \$733,893,000 was made to the Company's total capitalization, based on a pro rata reduction of long-term debt by \$373,806,000, a reduction to preferred stock by \$43,877,000, and a reduction to premium on capital stock by \$316,209,000 (Exhs. SU-1, at 10-11; SU-3, at 5).⁽⁵⁾ Fourth, the Company reduced its common equity by \$73,211,000

to eliminate (1) \$62,983,000 net gains from changes in the market value of investment securities held by a subsidiary of the Company, and (2) \$10,228,000 in retained earnings (Exhs. SU-1, at 12-13; SU-4). Therefore, the excess of utility plant amounted to \$253,772 as of December 31, 2000 (\$1,467,494,000 minus \$1,213,722) (Exh. SU-2).

IV. STANDARD OF REVIEW

In order for the Department to approve the issuance of stocks, bonds, coupon notes, or other types of long-term indebtedness⁽⁶⁾ by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess that the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II") citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.⁽⁷⁾ Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 841, citing Lowell Gas at 52. Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

Pursuant to G.L. c. 164, § 15, an electric or gas company offering long-term bonds or notes in excess of \$1 million in face amount payable at periods of more than five years after the date thereof must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the Department finds that an exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in the public interest to grant an exemption from the advertising requirement where there has been a measure of competition in private placement. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Berkshire Gas Company, D.P.U. 89-12, at 11 (1989). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). However, G.L. c. 164, § 15 requires advertising as the general rule; and waiver cannot be automatic but must be justified whenever requested.

Pursuant to G.L. c. 164, § 15A, a company is required to sell long-term bonds, debentures, notes, or other evidence of indebtedness at no less than the par value or face amount unless sale at less than par value is found by the Department to be in the public interest. See, e.g., Boston Edison Company, D.P.U. 91-47, at 13 (1991). The Department has found that it is in the public interest to grant an exemption from the par value requirement where market conditions make it difficult at times for a company to price a particular issue at par value and simultaneously offer an acceptable coupon rate to prospective buyers. Bay State Gas Company, D.P.U. 91-25, at 9 (1991). The Department also has found that it is in the public interest to authorize the issuance of debt securities below par value where this technique offers a company enhanced flexibility in entering the market quickly to take advantage of prevailing interest rates, particularly if this benefits the company's ratepayers in the form of lower interest rates and a lower cost of capital. Id.; see also Boston Gas Company, D.P.U. 92-127, at 8 (1992); Boston Edison Company, D.P.U. 91-47, at 12-13 (1991). If the Department authorizes a company to issue debt securities at less than par value, the Department may establish the method by which the company is required to amortize any discount.⁽⁸⁾ G.L. c. 164, § 15A; see, e.g., Boston Gas Company, D.P.U. 92-127, at 8; Boston Edison Company, D.P.U. 91-47, at 15.

V. ANALYSIS AND FINDINGS

A. Long-Term Debt

The Company's proposed financing consisting of the issuance and sale of long-term securities of up to \$400 million at a fixed rate of interest, with a single maturity date that is at least seven years but not greater than 30 years, is necessary to retire an equal amount of outstanding short-term debt. The proceeds from the sale will be applied to the refinancing of short-term debt incurred by the Company to purchase the utility property, plant and equipment of several natural gas companies, and to finance the expansion and replacement of investments in its utility operations, which is a legitimate purpose in meeting the Company's utility-service obligations.

Accordingly, the Department finds that the proposed issuance is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14.

In regard to the net plant test, the Department requires companies to demonstrate that their net utility plant equals or exceeds their total capitalization. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). If a company's financing proposal fails to meet this requirement, G.L. c. 164, § 16 authorizes the Department to prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time period the capital stock impairment.

As noted above, Southern Union has proposed a number of adjustments to its actual capital structure, including the elimination of plant and capital associated with the Company's unregulated operations and utility acquisitions. Concerning the proposed adjustment for unregulated operations, because the costs of unregulated operations, including those associated with capital costs, should not be borne by ratepayers, the Department accepts the Company's proposed plant and capitalization adjustments for unregulated operations. NYNEX Price Cap, D.P.U. 94-50, at 440 (1995); Colonial Gas Company, D.P.U. 84-94, at 51 (1984).⁽⁹⁾ Concerning the Company's proposed adjustment for acquisition premiums, the intangibility of acquisition premiums, or goodwill, renders it inappropriate for Department consideration as a component in a utility's capitalization for purposes of G.L. c. 164, § 14. New England Power Company, D.T.E. 00-53, at 8-9 (2000). Accordingly, the Department accepts the Company's proposed plant and capitalization adjustments for acquisition premiums.

The record demonstrates that, with these adjustments, the Company's total capital stock and long-term debt will not exceed the Company's net utility plant following the issuance and the sale of the long-term debt securities.⁽¹⁰⁾ Accordingly, the Department finds that the Company's issuance of \$400 million in long-term securities meets the net plant test as provided in G.L. c. 164, § 16.

Issues concerning the prudence of the Company's capital financing have not been raised in this proceeding and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Company or its customers.

The Department's determination in this Order is not in any way to be construed as a ruling relative to the appropriate ratemaking to be accorded any costs associated with the proposed financing.

Regarding the Company's request for approval of a maximum interest rate of 9.0 percent on the notes, recent market conditions have indicated that seven- to 30-year debt instruments would presently carry an interest rate of between 7.15 percent and 8.0 percent (Tr. at 17-18, 24). Because of market volatility, the ultimate coupon rate could vary from those available at the time of the filing of this petition (id. at 25). Under these conditions, some provision for an increase in interest rates is appropriate. In view of recent market conditions and long-term economic expectations, the Department finds that a maximum interest rate of 9.0 percent is consistent with the public interest. Accordingly, the Department will authorize an interest rate for the notes not in excess of 9.0 percent.

B. Exemption from G.L. 164, §§ 15, 15A

The Company has demonstrated that it has examined the status of competition in the placement process through its active solicitation of various investment bankers with broad experience in the bond market and access to potential investors (Exh. SU-11; Tr. at 20-22). As a result of this process, the Company has experienced significant success in its debt placements consistent with the objectives of newspaper advertising, as evidenced by an oversubscription to its previous debt financing completed in 1999 (Exh. SU-11; Tr. at 20-22). Moreover, the Company has demonstrated the benefits of timing its issuance to take full advantage of market conditions and obtain maximum attention from potential investors (Exh. SU-11). Requiring competitive bidding may well jeopardize the flexibility sought in these transactions, and ultimately jeopardize the financial benefits available to ratepayers under this placement process. Therefore, the Department finds that it is in the public interest to exempt the Company from the advertising requirements in G.L. c. 164, § 15.

The Company has also requested an exemption from the par value requirements of

G.L. c. 164, § 15A. Investors rely on such discounts as a means to refine the price structure of a debt instrument to achieve a desired interest rate (Exh. SU-12; Tr. at 22-23). Consequently, a discount provision offers enhanced flexibility which results in placing issuances with prospective investors at a market-based interest rate. Boston Edison Company, D.T.E. 98-118, at 43 (1999). Therefore, the Department finds that the Company's request for an exemption from the requirements of G.L. c. 164, § 15A is in the public interest and accordingly approves it.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, the Department hereby:

VOTES: That the issuance and sale by Southern Union Company, from time to time, of not in excess of \$400,000,000 aggregate principal amount of long-term debt, is reasonably necessary for the purposes for which such issuance and sale has been authorized, pursuant to G.L. c. 164, § 14; and

VOTES: That the issuance of the long-term debt is in accordance with G.L. c. 164, § 16 in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company, will exceed its outstanding stock and long-term debt; and

VOTES: That it is in the public interest that the issuance and sale of said long-term debt be exempt from the requirements of G.L. c. 164, §§ 15 and 15A; and it is

ORDERED: That the Department approves and authorizes the issuance and sale by Southern Union Company, in conformity with all the provisions of law relating thereto, of up to \$400 million principal amount of long-term debt securities which carries a maximum interest rate of 9.0 percent; and it is

FURTHER ORDERED: That Southern Union Company be exempt from all of the requirements of G.L. c. 164, §§ 15 and 15 A, as amended, with respect to the issuance and sale of said long-term debt securities; provided that if any of said long-term debt are issued and sold at less than par value or face amount, the discount shall be amortized over the stated term of the long-term debt; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of State of the Commonwealth.

By Order of the Department

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).

1. The Company states that market indications as of January 31, 2001 supported the issuance of seven-year notes at a coupon rate of 7.15 percent, and the issuance of 30-year notes at a coupon rate of 8.00 percent (Exh. SU-1, at 4).
2. This maturity date may be extended, provided the Company serves its notice of intent to extend no later than June 27, 2001 (Exh. SU-1, at 5).
3. The issuance of the proposed long-term debt is also subject to the regulatory approval of the Florida Public Service Commission and the Pennsylvania Public Utilities Commission (Exh. SU-1, at 5).
4. The Company's unregulated operations had been supported over the years through a combination of debt and equity (Exh. SU-1, at 10).
5. The Company stated that it has financed its acquisitions over the years through a combination of debt and equity, and cannot directly attribute the acquired plant to specific capital items (Exh. SU-1, at 11-12).
6. 6 Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

7.

7 The net plant test is derived from G.L. c. 164, § 16.

8. 8 The discount is the difference between the par value of a bond, note, or other debt security and the actual issue price when the actual issue price is less than par value.

9. Because the Department only recently acquired jurisdiction over Southern Union, we recognize that the Company's historic capitalization may vary from those of companies who have been under Department jurisdiction since their inception in the late 1800s.

10. Although Southern Union's total plant investment in Massachusetts is less than the amount of the financing sought, the Company's debt and equity financings are not specifically attributable to any particular jurisdiction (Exh. SU-1, at 9-11). Moreover, the Electric Restructuring Act of 1997 revised the definition of "gas company" to include non-Massachusetts corporations operating gas utilities within the Commonwealth. St. 1997, c. 164, § 189. Thus, the Company's combined operations are subject to the jurisdiction of the Department and the provisions of G.L. c. 164, § 14. Southern Union/Fall River Gas Company, D.T.E. 00-25, at 27 (2000); Southern Union/North Attleboro Gas Company, D.T.E. 00-26, at 26 (2000).